IN THE HIGH COURT OF NEW ZEALAND
AUCKLAND REGISTRY

CIV-2016-404-57
[2017] NZHC 1596

BETWEEN	ADAM DAVID BANKS Plaintiff
AND	WILLIAM ROBERT FARMER First Defendant
	SIMON MATHEW GAMBLE Second Defendant
	CHRISTOPHER JAMES MASSAM Third Defendant
	DOUGLAS LEROY FREDERICK Fourth Defendant

Hearing:	21 June 2017
Appearances:	J W A Johnson for Plaintiff R J Hooker and S Taylor for Second, Third and Fourth Defendants
Judgment:	11 July 2017

JUDGMENT OF ASSOCIATE JUDGE J P DOOGUE

This judgment was delivered by me on
***11.07.17 at 3.30 pm**, pursuant to*
Rule 11.5 of the High Court Rules.

Registrar/Deputy Registrar

Date……

Background

[1] These proceedings were served by substituted service on the fourth defendant, Mr Douglas Frederick, who resides in Texas, the United States of America ("USA"). They arise out of an investment which the plaintiff, Mr Adam Banks, made in a company called Mako Networks Holdings Limited ("Mako"**)** in accordance with three different agreements entered into from 2011 to 2014. Mako is now in receivership and liquidation.

[2] Although the fourth defendant now resides in the USA, he was appointed a director of Yellowtuna Holdings Limited ("Yellow") on 9 December 2011. That company later became Mako on 8 April 2013.

[3] It is not in dispute that the plaintiff made the payments which will be described in more detail subsequently in this judgment.

[4] After the proceedings were served on the fourth defendant in the USA, he filed a protest to the jurisdiction of the New Zealand Courts to hear the matter under r 5.49 of the High Court Rules ("HCR").

[5] The plaintiff seeks an order setting aside the fourth defendant's protest to jurisdiction dated 20 January 2017 in relation to the first, third and fourth causes of action, as set out in the plaintiff's amended statement of claim dated 29 June 2016 ("SOC").

What the plaintiff claims

[6] The plaintiff's claims are set out in full in his SOC. The relevant claims can be summarised as follows:

a) Under s 37 of the Securities Act 1978 ("SA"): the defendants should repay the plaintiff because Mako and the directors failed to comply with their obligations under the SA when raising money from the public;

b) Under s 55G of the SA: the defendants should repay the plaintiff's loans because they were entered into in reliance upon advertisements that included untrue statements made by Mako and the defendants; and

c) Under s 301 of the Companies Act 1993 ("CA"): the plaintiff, as a creditor of Mako, wants the defendants to repay a sum equal to the plaintiff's advances because they breached their duties as directors of Mako.

[7] I note that a claim was also brought pursuant to the Fair Trading Act 1986. The plaintiff accepts that that claim cannot proceed and agrees that the court ought to make an order setting aside the protest to jurisdiction on condition that the plaintiff re-plead its case to omit the Fair Trading Act claim.

The plaintiff's claim in more detail

[8] The plaintiff alleges the following.

[9] In late 2010, the plaintiff was approached by the first defendant (a director of Mako), Mr William Farmer, about investing in Mako. There were ongoing discussions between the two of them during late 2010 and early 2011.

[10] The plaintiff was provided with materials prior to agreeing to invest in Mako. One such material was the Mako Capital Raising Report dated November 2010 ("the Report") sent to him by the first defendant.

[11] The Report contained a substantial amount of financial information and forecasts, which the plaintiff relied upon when agreeing to invest in Mako.

[12] The first defendant advised the plaintiff that the clauses contained in the Report which sought to limit Mako's liability were not applicable in this situation because the Report was drafted for an earlier capital raising initiative by Mako.

[13] The Report listed the fourth defendant as Chairman of the Board of Mako. Mako's 2012, 2013 and 2014 financial statements also listed the fourth defendant as a director. The plaintiff relied on these representations.

[14] Mako, through the first defendant on its behalf, made a number of other representations to the plaintiff about the positive nature of Mako's financial situation and future business prospects before, during and after each agreement between Mako and the plaintiff.

[15] There were three agreements between Mako and the plaintiff for the plaintiff to lend Mako money:

a) **Agreement 1**: signed by both parties and dated 4 February 2011;[1]

b) **Agreement 2**: signed by both parties and dated 30 June 2013;

c) **Agreement 3**: an oral agreement between the plaintiff and the first defendant on behalf of Mako discussed and agreed to on 4 March 2014.

(together "the Agreements")

[16] The plaintiff paid and Mako received money in accordance with the Agreements.

[17] In early 2014, Mako and its related companies restructured existing finance debt with Telecom Rentals Limited, a Spark subsidiary. Part of the restructure required Mako to give a first ranking general security agreement over Mako's assets.

[18] The plaintiff's consent was never sought to the giving of such security, despite it being required under the Agreements.

[19] In early 2015, the plaintiff called up his advances to Mako and the interest owed.

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[1] I note that this Agreement was between Yellow and the plaintiff.

[20] Mako never repaid the plaintiff's advances and was placed into receivership by Spark on 21 August 2015. When placed into liquidation and receivership, Mako had liabilities totalling over $30,000,000.00, including approximately $26,000,000.00 worth of secured debt to Spark.

The protest to jurisdiction

[21] The fourth defendant claims that this Court does not have jurisdiction over him. In summary, the protest to jurisdiction says:

a) the fourth defendant resides in the USA;

b) the plaintiff has not pleaded any reliance on any particular act or conduct of the fourth defendant (they have never met);

c) the plaintiff did not obtain leave of this Court to commence proceedings against him in accordance with the HCR;

d) the plaintiff does not have an arguable case against him; and

e) the proper jurisdiction for a claim against the fourth defendant, if there is an arguable case, is in the USA.

[22] In response, the plaintiff argues that his claims against the fourth defendant were validly brought and served in accordance with the HCR. The protest needs to be set aside so that the proceeding can progress towards a hearing of the substantive matters.

The legal position

[23] Counsel for the fourth defendant, Mr RJ Hooker, submitted that the HCR require the proceedings to be dismissed if the protest to jurisdiction is not dismissed.

[24] Essentially, r 5.49 of the HCR allows a defendant to file an appearance objecting to the Court's jurisdiction to hear the proceedings. As service has been effected outside of New Zealand without leave in this case, and there has been a

protest to the court's jurisdiction under r 5.49, the court must decide whether to assume jurisdiction pursuant to r 6.29.

[25] Rule 6.29(1) relevantly provides:

> (1) … the court must dismiss the proceeding unless the party effecting services establishes–
>
> (a) that there is–
>
> (i) a good arguable case that the claim falls wholly within 1 or more of the paragraphs of rule 6.27; and
>
> (ii) the court should assume jurisdiction by reason of the matters set out in rule 6.28(5)(b) to (d); or
>
> (b) that, had the party applied for leave under rule 6.28,–
>
> (i) leave would have been granted; and
>
> (ii) it is in the interests of justice that the failure to apply for leave should be excused.

[26] There was no essential difference between the parties as to the test to be applied when determining if the protest should be set aside. The court must therefore apply a two stage approach.[2] The Court of Appeal has explained the approach:[3]

> [32] Where r 6.29(1)(a) is relied upon, there is a two-stage inquiry. The party effecting service must first establish under r 6.29(1)(a)(i) that there is a good arguable case that the claim falls wholly within one or more of the paragraphs of r 6.27 (relating to the circumstances in which service overseas may be effected without leave). This part of the inquiry may be regarded as a gateway or threshold which must be established before moving to consider the stage two issues.
>
> [33] The good arguable case test required at this stage does not relate to the merits of the case but to whether the claim falls within one or more of the circumstances under r 6.27 in which service overseas may be effected without leave. This is a largely factual question to be assessed on the basis of the pleadings and the affidavit or other evidence before the court. It may be necessary, however, to consider questions of law (or mixed questions of fact

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2 *Wing Hung Printing Co Ltd v Saito Offshore Pty Ltd* [2010] NZCA 502, [2011] 1 NZLR 754 at [32].

3 *Wing Hung Printing Co Ltd*, above n 2. Citations omitted.

> and law) as part of the first stage determination, for example, whether a contract was made in New Zealand or whether it was by its terms or implication to be governed by New Zealand law. Similarly if there is a question as to whether a binding contract was made at all (as in the present case).
>
> [34] It may be the case under some of the categories in r 6.27(2) that a conclusion in the first stage of the inquiry may substantially answer part of the second stage of the inquiry. For example, if it is established there is a good arguable case that there has been a breach of contract in New Zealand under r 6.27(2)(c) then the claimant should not have much difficulty establishing at the second stage of the inquiry that there is a serious issue to be tried on the merits. We discuss below the distinction between the tests of good arguable case and serious issue to be tried.
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> [35] If the party effecting service is able to satisfy the first stage test, then the court must consider in the second stage under r 6.29(1)(a)(ii) whether it should assume jurisdiction by reason of the matters set out in r 6.28(5)(b) to (d). For convenience, we repeat what those matters are:
>
> > (b) whether there is a serious issue to be tried on the merits;
> >
> > (c) whether New Zealand is the appropriate forum for the trial; and
> >
> > (d) any other relevant circumstances supporting an assumption of jurisdiction.
>
> [36] The Court is not required at this stage of the inquiry to consider r 6.28(5)(a) which relates to whether the claim has a real or substantial connection with New Zealand. The Court is not required to consider that matter because it is assumed to be established where the party effecting service has shown a good arguable case that the claim falls within one or more of the matters described in r 6.27.

The two-stage test

[27] First, as noted above, the plaintiff must establish by way of sufficient evidence a good arguable case that the claim falls within one or more of the circumstances under r 6.27 of the HCR in which service overseas may be effected without leave.

[28] In my view, there is a good case to be made that the proceeding falls within r 6.27(2)(h), which provides:

> (2) An originating document may be served out of New Zealand without leave in the following cases:

> …
>
> (h) when any person out of the jurisdiction is–
>
> (i) a necessary or proper party to proceedings properly brought against another defendant served or to be served (whether within New Zealand or outside New Zealand under any other provision of these rules), and there is a real issue between the plaintiff and that defendant that the court ought to try …

[29] It is possible to discern a sustainable argument that the fourth defendant is a necessary or proper party to the proceedings for reasons which largely appear from the subsequent discussion about whether there is a serious question to be tried on the disputes between the plaintiff and the fourth defendant.

[30] The first cause of action under s 37 of the SA lies against a person who was a director of Mako, such as the fourth defendant. The point of time at which such a defendant must be established to have been a director of the company is discussed later in this judgment. For the purposes of this part of the application, I consider that there is a real issue that:

a) the company, not having issued a prospectus, was not entitled to solicit funds from members of the public;

b) the plaintiff was a member of the public who has standing as a non-habitual investor to bring a claim pursuant to s 37 of the SA;

c) the plaintiff demanded to be reimbursed for the investments that he had made with the company; and

d) the issue is one which the court ought to try.

[31] The additional grounds are to be found in r 6.27(2)(j), in that the claim under s 37 arises under an enactment and an act or omission to which the claim relates was done or occurred in New Zealand. The latter may be seen as including the taking of a deposit from the plaintiff or the omission to refund the deposited fund subsequently.

[32] In regard to the second cause of action, pursuant to s 55G of the SA, there is a basis for concluding that an act or omission to which the claim relates took place in New Zealand. That act or omission was the misrepresentation which is allegedly contained in the Report about the financial strength of, and the prospects of, Mako to carry on a profitable business.

[33] The third cause of action is the claim pursuant to s 301 of the CA. The investment which the plaintiff made in the company was allegedly all lost when the company failed. The causes of the company's failure did not accrue at any one time, according to the claim which the plaintiff brings. The failure arose from the continuing process of the directors permitting the company to trade in circumstances where large losses were being incurred, which meant that the capital of the company would be lost and that claims by creditors would be rendered valueless.

[34] In my judgment, a good arguable case can be made that the claims fall within the provisions of r 6.27 which I have identified.

[35] I must now consider whether the court should assume jurisdiction by reason of the matters set out in r 6.28(5)(b) to (d), namely the second stage of the test.

Rule 6.28(5)

[36] The next question is whether the claims satisfy the requirements of r 6.28(5)(b) to (d) of the HCR.

[37] The first requirement in r 6.28(5) is sub-rule (a), namely that the claim have a real and substantial connection with New Zealand. I am not required to consider that matter because, as the Court of Appeal noted, it is assumed to be established where the party effecting service has shown a good arguable case in respect of r 6.27.[4] Here, the plaintiff has.

[38] The next requirement of r 6.28(5) is imposed by sub-rule (b), which is a requirement that there be a serious issue to be tried on the merits.

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4 *Wing Hung Printing Co Ltd*, above n 2, at [36].

[39] Counsel referred to *Wing Hung Printing Co Ltd v Saito Offshore Pty Ltd*, in which the Court of Appeal said:[5]

> [37] … the Court must be satisfied there is a serious legal issue to be tried and that there is a sufficiently strong factual basis to support the legal right asserted …
>
> [42] The serious issue to be tried test to be applied at the second stage of the inquiry was described by Lord Goff in *Seaconsar* as whether "… at the end of the day, there remains a substantial question of law or fact or both, arising on the facts disclosed by the affidavits, which the plaintiff bona fide desires to try …".

[40] The reference to *Seaconsar* is to the leading English case of *Seaconsar Far East Ltd v Bank Markazi*.[6]

[41] I will now examine each of the causes of action pleaded in order to see whether I consider there to be a serious issue to be tried in respect of each one.

Securities Act 1978, s 37

[42] The first cause of action which I will consider is that brought under s 37 of the SA.

[43] It is the claim of the plaintiff that he advanced sums of money to Mako on the basis of an "advertisement", as that term is relevantly defined in the SA.[7] He did so in circumstances, he says, where no prospectus had been issued. It is his case that the Report constitutes an advertisement that contained misleading and untrue representations by the directors.

[44] The causes of action under the SA refer to the three agreements outlined earlier, which the plaintiff alleges were entered into pursuant to which the plaintiff obtained convertible notes issued by Mako.

[45] The contentious points that arise under this cause of action are:

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5 *Wing Hung Printing Co Ltd*, above n 2, Citations omitted.

6 *Seaconsar Far East Ltd v Bank Markazi* [1994] 1 AC 438 (HL). This was applied in *Wing Hung Printing Co Ltd*, above n 2.

7 Section 2A.

a) Whether the offer of securities to the plaintiff was part of an offer of securities to the public; and

b) Was the fourth defendant a director? By what dates did he need to be a director to be liable and, if not, would a de facto director be caught by the terms of s 37?

Was the plaintiff a member of the public?

[46] A claim under s 37 is only actionable where there has been an offer of securities to the public. Whether or not a person is to be regarded as a member of the public depends upon whether he or she falls within one of the categories in s 3(2) of the SA, which provides as follows:

> **3 Construction of references to offering securities to the public**
>
> …
>
> (2) None of the following offers shall constitute an offer of securities to the public:
>
> (a) an offer of securities made to any or all of the following persons only:
>
> (i) relatives or close business associates of the issuer or of a director of the issuer:
>
> (ii) persons whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invest money:
>
> (iia) persons who are each required to pay a minimum subscription price of at least $500,000 for the securities before the allotment of those securities:
>
> (iib) persons who have each previously paid a minimum subscription price of at least $500,000 for securities (the **initial securities**) in a single transaction before the allotment of the initial securities, provided that—
>
> (A) the offer of the securities is made by the issuer of the initial securities; and
>
> (B) the offer of the securities is made within 18 months of the date of the first allotment of the initial securities:

(iii) any other person who in all the circumstances can properly be regarded as having been selected otherwise than as a member of the public:

(b) an invitation to a person to enter into a bona fide underwriting or sub-underwriting agreement with respect to an offer of securities.

…

[47] For the fourth defendant, it was noted that the plaintiff agreed to provide large sums of money to Mako. The amounts were as follows:

a) Agreement One – approximately NZ $1,300,000;

b) Agreement Two – approximately NZ $600,000; and

c) Agreement Three – approximately NZ $500,000.

[48] The fourth defendant asserts that the very fact that he has large amounts of money points against the contention which the plaintiff puts forward, namely that he is not an investor as described in s 3. This was reviewed by counsel as providing support for the proposition that the plaintiff was a habitual investor. In other words, there was no offer of securities to the public because the exception in s 3(2)(a)(ii) applied.

Habitual investor

[49] Before commencing an analysis of the application of that section, I note the general submission that was made for the fourth defendant that in the present proceeding, there is no statement in an affidavit by the plaintiff affirming the SOC as a matter of evidence, which is the way that a plaintiff in a summary judgment is required to proceed. The fact that such a procedure was adopted in summary judgment cases is neutral as to whether it should be adopted in a case of this kind.

[50] However, I do not consider that an explicit confirmation of the contents of the SOC is required in a case of protest to jurisdiction, such as that of the present kind. This is not a case where the plaintiff needs to prove anything on the balance of

probabilities. Rather, it is a case which the court must consider all of the material and decide whether the requisite matters are established. Given that the application and such affidavit evidence as the plaintiff has filed are plainly provided in the context of, and against the background of, the SOC, I see no justification for penalising the plaintiff because he has not gone one step further and explicitly affirmed the contents of the SOC on oath.

[51] The first point that therefore arises is whether in this case the offer of securities came within the SA, having regard to the provisions of s 3(2)(a)(ii).

[52] The focus of the fourth defendant's claim was on the question of whether the plaintiff in this case is someone who, in the course of and for the purposes of his business, habitually invested money. In the affidavit he filed, Mr Banks swore:

> 7. I do not consider myself to be a habitual, professional or qualified investor as claimed by the fourth defendant.

[53] Mr Hooker was critical of the quality of the evidence which the plaintiff provided, namely the bald assertion that he was not a habitual investor, characterising that as inadmissible evidence of "opinion". I will briefly deal with that issue by way of a detour from the principal argument that I am considering.

What evidence is admissible on the hearing of the application?

(a) The emails

[54] In his oral submissions, Mr Hooker said that there was evidence from email exchanges between the fourth defendant and the chairman of Mako, Mr Farmer (the first defendant), that the fourth defendant had suggested that the parties enter into their own arrangements for payments generated by the Mako investment to be remitted to the plaintiff in the UK by means of them providing their own mechanism. As I understand it, this would have involved the plaintiff allocating a certain number of pounds stirling to Mako when making his investments, which would somehow be held on Mako's behalf in the United Kingdom. In this way, the plaintiff would pay for the securities. Conversely, the dividends or returns on the securities would be

held in New Zealand for the credit of the plaintiff. The parties agreed to the mechanism by which the necessary currency conversion rates would be adopted.

[55] The fourth defendant relies upon evidence of communications between the parties, in the course of which the plaintiff made reference to the fact that he kept records in books of account. The Mako investments were noted in those books. Mr Hooker submitted that both these two items of evidence point towards the fact that the plaintiff was a habitual investor.

[56] However, Mr Hooker was making reference to emails allegedly exchanged between the parties which were not in evidence. The plaintiff objected to them being taken into account for that reason.

[57] I was concerned that to rule in favour of the plaintiff on this aspect of the case might seem to be inconsistent with the approach that I had taken above, namely having regard to the SOC which is of course not an item of evidence that is put before the court in sworn form. However, the decision is not entirely to be resolved by looking at issues of evidence but is also to be determined by looking at the form of the case which the plaintiff puts forward. There is nowhere that that is more explicitly stated than in the SOC. Further, Mr Johnson for the plaintiff pointed to the fact that the SOC is part of the court record and is naturally part of the case which the court would advert to.

[58] The emails to which reference has just been made do not fall into such a category.

[59] I consider on balance that the submissions which Mr Johnson made on this point are correct. Given that there is no concession that the emails ought to be referred to, I do not intend to take them into account.

[60] That means that the evidence which is to be taken into account is the deposition by the plaintiff that he is not a habitual investor and the evidence of the three investments which the plaintiff made (which I have set out above).

(b) Statements of opinion or belief

[61] The first point to note is that the legislature did not prescribe any deemed meaning for the words in s 3(2)(a)(ii) of the SA:

> …
>
> (ii) persons whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invest money:
>
> …

[62] I will refer to that definition by using the condensed expression 'habitual investor'.

[63] Plainly, the expression was adopted by the legislature in order to differentiate between persons who were sophisticated in the matter of investment and securities, and who therefore presumably would not require the same level of statutory protection, from those who were not as accustomed to dealing with such matters. The latter group are deemed vulnerable, while the former are not.

[64] Strictly speaking, the question of whether a person is a habitual investor ought to be resolved by the plaintiff providing detailed evidence of his business activities, then the court making an evaluation whether the primary facts before the court justify a conclusion that he is or is not a habitual investor within the category defined in the SA. In making that decision, the court would consider what the legislature intended by adopting that phrase and then consider whether on the facts established the plaintiff was a habitual investor, as the legislature use that term. Instead the plaintiff has presumably considered his own recollections as to what his pattern of investing has been, how that fits with any business that he is involved in and the number of transactions he has habitually entered into concerning other matters. He has then made his own judgment about whether or not that made him a habitual investor within the meaning of the SA.

[65] It is important though to remember that the current application is an interlocutory application. In terms of r 7.30 of the HCR, a Judge is able to accept

statements of belief, in which the grounds for the belief are given, if it is in the interests of justice to do so.[8] There are other circumstances in which such statements of belief may be accepted. However, the terms in which r 7.30 are expressed make it clear that, even in cases of interlocutory applications, statements of belief will only be accepted if the grounds are set out. That the plaintiff has not done.

[66] Guidance on the question of whether evidence should be permitted in circumstances where it does not strictly comply with the rules of evidence is to be found in the decision of *Vincent v Police*.[9] The Court of Appeal was considering restraining orders as a prelude to the determination of the substantive question, namely whether the relevant property was tainted property or that the particular person unlawfully benefited from significant criminal activity which could give rise to orders for confiscation. In those circumstances, the Court considered that the alternative to allowing such a relaxed approach in circumstances such as those would mean that a "very elaborate evidentiary basis for the issue of restraining orders" would be required, which would be "impractical and inconsistent with the approach taken in other contexts".[10]

[67] As the Court noted in the *Vincent* case, a similar approach had been taken in a case involving a caveat under s 145A of the Land Transfer Act 1952.[11]

[68] The last mentioned case was one where the legislation required there to be a reasonably arguable case established. I consider that the proceedings in the present case, where it must be established that there is "good arguable case", are substantially similar. The conclusion which the court is being asked to come to is a provisional one only. It is not dispositive of the rights of the parties. It is given in contemplation of substantive proceedings which may or may not have this effect. For those reasons, I do not consider that the strict requirements of the laws of evidence are required to be met in an application of this kind. The evidence that Mr Bank's has provided, namely that he is not a habitual investor, can therefore be admitted.

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8 Rule 7.30(1)(c).
9 *Vincent v Commissioner of Police* [2013] NZCA 412.
10 At [47].
11 *Trustees Executors Ltd v Eden Holdings (2010) Ltd* [2010] NZCA 626.

(c) Further emails

[69] The fourth defendant made reference to two other categories of documents which he considered were persuasive on the question of whether the plaintiff was a habitual investor. Both of these categories comprised emails. I reviewed the documents without ruling on their admissibility. The plaintiff objected to them coming into evidence.

[70] In one of the documents, the plaintiff makes reference to the fact that he and Mako should be able to devise their own currency exchange mechanism, by means of which profits or interest which the plaintiff earned in New Zealand would be remitted to the United Kingdom. They could do this by recognising mutual credits for each other in the currency of the country where they were based. This will enable them to avoid paying commissions or fees arising from exchanges carried out through the banking system.

[71] In the second document, the plaintiff is recorded as having noted his Mako transactions in records that he kept of his accounts generally.

[72] There is no doubt that this evidence would be relevant to the issue of whether or not there is a serious issue to be tried on the merits of whether the plaintiff is a habitual investor.

[73] However, the documents were not authenticated by being attached to an affidavit that a party gave on behalf of the fourth defendant.

[74] In my view, while the court when dealing with an interlocutory application has some discretion, that does not extend to accepting documents as evidence in the case when there is no declaration or oath in explaining the provenance. It is certainly the case when the opposing party objects to such matters being considered by the court. Of course, if there was consent, there would be no difficulty. In my judgment, the emails that I have been referring to cannot be considered for the purposes of this application.

Discussion – was the plaintiff a habitual investor?

[75] The issue that is being considered under the cause of action based on s 37 of the SA is therefore whether it can be said, in the light of such evidence as there is, that the plaintiff does not have a good arguable case. Another way of stating the position of the defendants might be that they are contending that it is beyond argument that the plaintiff is one of those class of "persons whose principal business is the investment of money or who, in the course of and for the purposes of their business, habitually invest money".[12]

[76] The accepted fact that the plaintiff has made three investments over a period of two years approximately, albeit of substantial amounts, does not in my view demonstrate that it is not open to him to contend that he is not a habitual investor. It is not enough to show that it is his business, nor does it show the degree of repetitiveness or constancy that is required for him to be a habitual investor.

[77] The amounts of the investments are a neutral factor in my view. It is not beyond the realms of possibility that individuals with private wealth could invest sums of this magnitude without deriving them from a business or from a pattern of habitual investment. They could be a person's lifetime savings or an inheritance or come from some other source, just as equally as from business or repetitious investment.

[78] I consider that, in regard to this cause of action, there is a serious issue to be tried on the merits of the claim that the plaintiff was a person who was entitled to the remedies provided by s 37 of the SA.

[79] I will now briefly address a number of other points that were raised in relation to this first cause of action. None of these points impact my overall conclusion that there is a serious issue to be tried under s 37 of the SA.

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[12] Securities Act, s 3(2)(a)(ii).

Effect of the acknowledgment that the fourth defendant was a habitual investor

[80] The fourth defendant raises another point, namely that the CRR clearly states that a depositor could not participate unless they were a habitual investor. It is said:

> The depositor [i.e the plaintiff] accepted by virtue of being a habitual investor that the Securities Act 1978 did not apply.

[81] The difficulty with this submission is that s 4 of the SA provides that contracting out is prohibited.[13] There is at least a serious question to be tried that the SA applied, notwithstanding any purported agreement that the plaintiff might have entered into to the contrary.

The "no warranty" provision in the Report

[82] In relation to s 37, Mr Hooker put forward the additional contentions that the Report made it clear that any statement made in the Report could not be relied on, as its provisions were not to be read as containing any representation or warranty. How would the plaintiff be able to get round this provision, Mr Hooker asked in effect.

[83] Mr Hooker also made reference to the Report containing advice that the investor should obtain independent advice and review of the document.

[84] I consider that these arguments are met by the consideration that, unsurprisingly, this consumer/investor protection legislation does not allow for institutions which take funds from the public to contract out of any liability in relation to the protections which the legislation is intended to provide. Such an approach would deprive the legislation of much of its beneficial effect. It is no doubt for that reason that the SA contained the "no contracting out" provision to which I have already made reference and which is fatal, in my view, to the contentions made under this heading as well.

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[13] Section 4(1) and (2).

The allegation that the fourth defendant never personally made any statements to the plaintiff

[85] The fourth defendant says, in the material filed in support of the application to set aside the protest under jurisdiction, that the fourth defendant is not alleged to have personally made any statement to the plaintiff. I accept that it is correct that the plaintiff and the fourth defendant never met or communicated.

[86] The fourth defendant became a director of Yellow (which became Mako) in December 2011. By that time, the first of the advances had been made by the plaintiff to Yellow/Mako.

[87] I am not aware of any requirement that a director or a company sued under s 37 of the SA can only be liable if it is proved that he made a representation directly to the claimant.

[88] The true position is that the plaintiff relies on the fact that the fourth defendant was a member of the board of directors of Mako. It is correct that none of the agreements entered into with the plaintiff were signed by the fourth defendant. Again, there is no requirement that that should occur.

[89] The position of director of a company was considered in the Court of Appeal case of *Chean v De Alwis.*[14] In that case, the director's argument was that she should not be liable because she was not a director when the unlawful allotment, which triggered the repayment obligation under s 37(6) of the SA, occurred. The Court of Appeal said:[15]

> [47] … We think it is clear that s 37(6) does not apply only to directors who were in office at the time of an invalid allotment. If the provision was limited in that way, it would say so. On any view, it is clear that s 37(6) applies to a director who is in office at the date on which the repayment obligation arises.

[90] As *Chean* thus makes clear, the status of the director at the time when the repayment obligation arose is the critical time. Therefore, the focus is on the status

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14 *Chean v De Alwis* [2010] NZCA 30.
15 At [47].

of a person as a director and they will be liable even if they have not signed any document or taken part in a board resolution to approve a particular transaction.

[91] There is some doubt about when the duty to repay accrued in the case of the first loan. At that time, the fourth defendant may not have been a director.

[92] There is a further level of uncertainty about the date when the fourth defendant became a director, caused by the terms of the Report. There is no doubt that at the time when this document was issued by the company, the fourth defendant was a director. At page 12 of that document, it is stated that:

> [the fourth defendant] has been associated with Mako since mid-2009. In February 2010 he joined the board as chairman.

[93] The fourth defendant in his affidavit says that he was appointed as a director on 9 December 2011, with the appointment being registered with the Companies Office on 12 January 2012.

[94] Mr Johnson for the plaintiff asserted that there was evidence, presumably based on the Report, that the fourth defendant was a de-facto director of the company.
Mr Johnson cited the judgment of Lang J in *HLH Equity Trading Ltd v White.*[16] In his judgment, Lang J accepted that a person who was not formally or validly appointed as a director could be held liable to investors under the SA:

> [65] … if it can be demonstrated that they carried out functions that would ordinarily be within the domain of the directors of the company.

[95] The problem in this case is that there is a paucity of evidence on the question of whether the fourth defendant was a de facto or legal director at the time when the plaintiff made the first investment in February 2011.

[96] There are a number of possibilities that explain the apparent conflict between the statement in the Report that the fourth defendant was a director of the company, and by inference had that status as at January 2011, and his express averment that he did not become a director until 9 December 2011.

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16 *HLH Equity Trading Ltd v White* HC Tauranga CIV-2009-470-40, 24 May 2010.

[97] One could take the view that it is unlikely that those in control of this multimillion dollar company would have been genuinely mistaken about whether the defendant was a director as at January 2011. It would seem odd that those who prepared the document could have been mistaken about the question of whether the defendant was a director, let alone, as stated above, that he was the chairman of directors. On this view of matters, the plaintiff might have been functioning as a director without the appropriate steps to register his status having being taken because of oversight.

[98] There is, however, a number of considerations which would suggest that the dispute about the date of appointment is not a material issue in the case. I have referred above to the authority of *Chean*, which provides guidance upon the appropriate date at which the status of a director is important. That is the date at which the repayment obligation arose. Understandably, there was not any argument about this point before me. However, assuming that a repayment obligation does not accrue until the person entitled makes a request or demand, it would seem to be unlikely that that event occurred in the early stages of the investing history between the plaintiff and Mako networks. An inference can be drawn that because the plaintiff was still making lodgments in 2013, disillusionment on his part with Mako networks had not set in and therefore the further inference arises that, at least up until that date, he had not made a demand.

[99] Mr Johnson reminded me that the plaintiff has not had discovery in this proceeding. Any discovery would no doubt include minutes of directors meetings and other evidence about the participation of the fourth defendant in the activities of Mako networks.

[100] The claimed liability under s 37, would arise where:

a) there had been no compliance with the requirement for the provision of a prospectus;

b) an investment;

c) a failure to repay the investment as being an invalid allotment;

The "equitisation" point

[101] Mr Hooker made the following submission concerning the equitisation point:

> 8. On 30 June 2013 the Plaintiff agreed to forgo his debt security (if that existed in terms of the Securities Act 1978) in exchange for shares when the float occurred. In that sense he was no longer a creditor of Mako but a shareholder in waiting. This is confirmed by the financial statements of Mako.

[102] This contention is not directed at the factual matters which are disputed and which the plaintiff will need to prove at trial. It instead comes down to a question of the legal effect of an agreement that the plaintiff entered into and the status, if any, of that agreement and whether it had any potential to alter the rights of the plaintiff under the SA.

[103] There does not appear to be any fundamental difference between the parties as to what the possible effects of the equitisation agreement were. That effect is that it allegedly altered the position of the plaintiff from that of a creditor of the company to a shareholder. That is not the real issue, though, which arises when attempting to resolve whether there is a seriously arguable issue about whether the equitisation agreement defeats the rights of the plaintiff under the SA.

[104] The issue that is actually raised is whether the agreement, if entered into and valid, had the immediate effect of altering the status of the plaintiff. Or, alternatively, that the status of the plaintiff as creditor continued up until the time the agreement was executed and his investments in the company were converted into issue shares.

[105] At most, if the equitisation defence was proved and was capable of being a complete and obvious answer to the plaintiff's claim, there would no longer be a serious issue to be tried on the merits that the plaintiff had claims for the recovery of his money from the defendants.

[106] The putative agreement is recorded in a letter which Mr Farmer wrote on behalf of Mako on 30 June 2013. He commenced the letter by referring to the three tranches and accumulated interest that were owing to the plaintiff, totalling £1,268,291.05. The key clause then reads:

> 3. Equitisation
>
> The Lender and Borrower wish to amend the Debt Letter Agreement subject to clause 4(h)(i) as follows:
>
> The Borrower has indicated to the Lender that it has initiated a further capitisation programme and is likely to list on the New Zealand stock exchange ("NZX").
>
> …
>
> The lender has agreed to transfer the total of advances and interest due as at 30 June 2013 in New Zealand dollar and equity in Mako upon completion of the NZX listing.

[107] Mr Hooker said that as a result of signing this agreement:

> In that sense [the plaintiff] was no longer a creditor of Mako but a shareholder in waiting. This is confirmed by the financial statements of Mako.

[108] In the first place, Mr Hooker's contentions would have the remarkable effect that the 30 June 2013 agreement, if it was in fact entered into between the parties, would have to be interpreted as having the effect that the plaintiff relinquished all rights in respect of Mako during the period between the date when he entered into the equitisation agreement and the date when he had received shares upon the listing on the NZX. It is common ground that the listing never actually occurred. Therefore, the plaintiff never received any shares in the company. The result is that for the defendant's contentions to be given effect to, it would have to be the conclusion of the court following trial that the plaintiff agreed that, notwithstanding that he had paid over £1,000,000 to Mako, from the point when he signed the equitisation agreement he had no legal rights against Mako at all and the only rights that remained with him constituted the provisional entitlement to obtain shares when the agreement was finally executed. But during the hiatus he would have no rights and, of course, that he ran the risk that the NZX listing would never occur. If the listing never occurred, the company would keep the money without providing any

consideration for it. On the fourth defendant's view of matters, the plaintiff elected to take that risk. That to my mind is suggesting that the plaintiff agreed to an arrangement that was irrational. At the very least, there would be a seriously arguable issue to be tried concerning that contention as well.

Securities Act 1978, s 55G

[109] In addition to seeking the recovery of the payments made because they were part of an irregular allotment in that there was no prospectus issued, the plaintiff also brings a claim under another part of the SA, s 55G. The plaintiff alleges that untrue statements were made in the Report of January 2011. The plaintiff has asserted that his loans were made to Mako in reliance upon the financial and strategic representations set out in the Report. The contention of the fourth defendant is that for a claim under s 55G to succeed, the fourth defendant had to be a director at the time of the advertisements.

[110] In the SOC, the plaintiff identifies the Report as being the "advertisement". It is pleaded:

> 145. Save for the Fourth Defendant who became a director of Mako on 9 December 2011, the Defendants were directors of Mako as the issuer at the time the advertisements were distributed.

[111] The fourth defendant regards this statement as being fatal to a claim under s 55G.

[112] However, the question of which parties are liable for the statements is regulated by s 56 of the SA. The section makes a person liable to pay compensation for distribution of an advertisements that includes untrue statements where:

> …
>
> (b) in the case of an advertisement, the person –
>
> …
>
> (ii) has authorised himself or herself to be named and is named in the advertisement as a director of the issuer or as having agreed to become a director immediately or after an interval of time.

…

[113] I have already made reference to the fact that the Report described the fourth defendant as being the chairman of the board. I accept that there is no explicit evidence in this case of the fourth defendant, Mr Frederick, expressly authorising himself to be named as a director of the issuer in the Report. I agree, however, that there is an inherent improbability in the contention that the fourth defendant's name would not have appeared amongst those of the other directors in such a document unless he had agreed to that happening. There is therefore a serious issue to be tried concerning the question of whether the fourth defendant is caught by s 55G.

Companies Act 1993, s 301

[114] The plaintiff further pleads that the Report included a budget for the group. It showed net profits before tax as follows:

2011 - 1,542,069

2012 - 1,103,714

2013 - 16,525,974

2014 - 35,564,149

2015 - 52,980,072

[115] The fourth defendant provided some documents in evidence at the hearing before me. These were not authenticated by being attached to an affidavit. I have already made reference to the fact that the plaintiff did not accept some of these documents. However, the plaintiff raised no objection to the provision of the Mako statements of financial position. These show:

2012 - -6149

2013 - 13,906

[116] The annual report from which those figures were taken was for 2013. The notes to the financial statements included the following comment:

> Mako faces challenges as a startup and fast growing business. However the directors consider the going concern assumption is appropriate for the group and company. There is always uncertainty as to whether the company and group will achieve future growth and profitability within the time frame set by the board. In the event the group of company fails to achieve future profitability as planned and or it fails to raise additional financing or equity as required, it is likely the company and group will not be able to continue as a going concern.

[117] The notes to the accounts also showed that, as at 30 June 2013, the group "had negative equity funds of $13,906,000".

[118] The company was liquidated on 20 August 2015.

[119] The case of the plaintiff pursuant to s 301 involves contrasting the roseate predictions of net profit which were made in 2011 with the actual figures that were achieved. The 2012 result, which the accountants prepared for the period for a little over a year later, that is to March 2012, showed a deterioration of the approximate projected $8,000,000 profit to a net loss after tax of $6,000,000 – in round figures. The plaintiff asserts that there is a serious issue to be tried as to whether the directors have been guilty of negligence, default or breach of duty in relation to the company pursuant to s 301.

[120] A claim under s 301 would cover a situation where the directors have permitted the business to carry on to a point where the company's assets were plainly going to be swallowed up by recurrent losses. Whether or not the directors in such a situation should have earlier brought the trading of the company to a halt before large-scale losses were incurred is a serious question to be tried at the hearing of this matter, in my view.

HCR 6.28(5)

[121] I also consider that the other requirements of r 6.28 of the HCR are satisfied.

[122] Rule 6.28(5)(c) concerns whether the applicant has established that New Zealand is the appropriate forum for the trial.

[123] I consider that it is so established. Most of the parties involved in this proceeding are resident in New Zealand, it would appear. It is likely that witnesses will come from New Zealand. For example, the actual state of the company's finances around the time when the three payments were advanced to the company will be closely scrutinised. There will be witnesses who can provide probative testimony on those issues. Documents relating to that issue will need to be disclosed and acquired by court order if they are not disclosed. All that is best achieved in a New Zealand Court given that most of the persons holding documents and the location of the documents themselves is likely to be in New Zealand. The parties to the agreements also agreed that New Zealand law would govern their disputes. It is more efficient for the laws of New Zealand to be applied in New Zealand courts than in other jurisdictions.

Discretion under HCR 6.29

[124] The plaintiff has fulfilled the two stage test. He has a good arguable claim that his proceeding comes within r 6.27. The matters referred to in r 6.28(5)(b)-(d) are satisfied and, in particular, the plaintiff is able to demonstrate that there is a serious issue to be tried on the merits concerning whether he is a member of the public entitled to the recovery of his investment under the SA.

[125] The plaintiff has therefore satisfied the requirements under r 6.29(1)(a) of the HCR, meaning the court is entitled to assume jurisdiction.

[126] Alternatively, I consider that the requirements under r 6.29(1)(b) would equally be satisfied. It is in the interests of justice that the failure to apply for leave ought to be excused. The other parties to these transactions, which are broadly connected to the collapse of Mako themselves, are facing the extant claims in New Zealand in this proceeding. It is desirable that all claims be heard together. There may be additional factors as well which support this conclusion that they are not necessary. It is open to the court, having considered the application of rr 6.27 and 6.28 and the findings that have been made in regard to those two rules, to conclude that it is in the interests of justice that failure to apply for leave ought to be excused.

[127] The result is therefore the application on notice to set aside the appearance under protest to jurisdiction is granted.

Costs

[128] The parties should confer on the question of costs and, if unable to agree, are to file memoranda not exceeding six pages on each side within 10 working days of the date of this judgment.

_____
J.P. Doogue
Associate Judge